Impact Assessment	
Title of measure	The Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations 2018 Clarifying and strengthening trustees' investment duties
Lead Department/Agency	Department for Work and Pensions(DWP)
Expected date of implementation	6 October 2018
Origin	Domestic
Date	14/6/18
Lead Departmental Contact	Deborah Sawyer
Departmental Assessment	Self-certified

Rationale for intervention and intended effects

Pension scheme trustees must take investment decisions which are in the best interest of the scheme members. This can introduce problems, where the decisions taken by trustees may not reflect the best interest of members.

There is confusion amongst pension scheme trustees and their advisers with respect to trustees' fiduciary duty surrounding certain investment decisions which could mean that investments are not taking full account of all relevant risks and opportunities - which might in turn affect members' pensions.

The Law Commission is an arms-length body of the Ministry of Justice whose purpose is to provide advice on request to Government Departments on issues of interest. They were commissioned twice to offer views on pensions – first in 2013 (reporting in 2014) by the then Department for Business, Innovation and Skills (BIS) and DWP on clarifying pension schemes' fiduciary duties and those of investment intermediaries, and the second in 2016 (reporting in 2017) by the Cabinet Office on the barriers to social investment by pension schemes.

The Law Commission found in both the above pieces of work that the fiduciary duty requires trustees of pension schemes to take financially material factors into account whatever their source.

The Law Commission has also reported that trustees can take into account members' views when making an investment decision but they are not obligated to do this. They laid out a 2-stage test which must be met to enable trustees to do this.

There is evidence that many pension scheme trustees mistakenly believe that considerations such as those stemming from Environmental, Social and Governance (ESG) causes are ethical concerns that *can* be taken into account when making investment decisions but never need to be taken into account as long term financially material considerations. There is also trustee confusion around what is meant by the term 'ESG'.

Due to these misunderstandings, trustees may not be making the best investment decisions for their scheme members, or utilising the full range of investments or the most appropriate investment strategies available to them.

The intended effects of these policy proposals is to improve investment decision making by pension trustees and enable a more uniform consideration of financially material risks. The intent is that trustees of larger schemes (those with 100 or more members) will need to take steps to ensure that members understand how their views are taken into account in investment decision making. In addition trustees of larger defined contribution schemes will need to review their investment decisions more transparently and offer members easier access to information

Viable policy options (including alternatives to regulation)

The viable policy options are:

1. Do nothing
2. Review and improve existing guidance
3. Introduce Statutory Guidance
4. Regulate to include additional policies within a Statement of Investment Principles (SIP) about:
   - financially material considerations including environmental, social and governance (ESG) considerations including climate change;
   - stewardship of the investments ; and
   - (supplementary to the SIP) how members' views are taken into account (if at all).

5. In addition to option 4, for relevant schemes, regulate to publish the Statement of Investment Principles and produce and publish both an implementation report on how the scheme has implemented the SIP policies and any changes to it, and their statement on how they will take account of members' views.

Initial assessment of impact on business

The preferred options which are monetised are options 4 and 5.

<u>Option 4</u>

There will be direct costs on certain pension schemes to update the Statement of Investment Principles to include information about their *existing* policies on financially material considerations (specifically Environmental, Social and Governance, including climate change), stewardship and, separately (supplementary to the SIP), a statement on how they will take account of members' views on the matters covered in the SIP.

There could be indirect costs on trustees of pension schemes where they choose to update their existing policies on any of their investment considerations, including Environmental, Social and Governance considerations (including climate change) and stewardship and where they choose to update their policy on how they take members' views into consideration.

There will be benefits to pension scheme trustees through clarification of their duties enabling better investment decision making and reducing confusion with reporting of financially material risks. Ultimately this will lead to benefits to members. It would entail disproportionate costs to monetise these benefits within this assessment.

The estimated annual net direct cost to business (EANDCB) over a ten year policy period for Option 4 is £2.3m

<u>Option 5</u>

In addition to costs for Option 4 there are direct costs on trustees of certain pension schemes to prepare an annual implementation report on how they have met their Statement of Investment Principles, and any changes to the SIP and to publish this report, as well as publishing the Statement of Investment Principles and their statement on how they take account of members' views.

The EANDCB over a ten year policy period for Option 5 over Option 4 is an additional £0.9m

The EANDCB for Option 5 over a ten year policy period is £3.2m so the impact assessment qualifies for self-certification.

Departmental signoff (*SCS*):Fiona Walker Date: 18/5/18

Economist signoff (*senior analyst*): Andrea Lee Date: 13/6/18

Better Regulation Unit signoff: Prabha Mistry Date: 23/5/18

URN: BIS/16/178

Evidence Base

Background

Occupational and personal pension schemes:

1. Private pensions can be either occupational (usually trust based) or personal pensions, including group person work place pensions (which are usually contract-based). The category into which they fall affects which regulations they must comply with and which body is responsible for regulating them.

2. The policy measures proposed in this impact assessment affect occupational pension schemes and these are regulated by The Pensions Regulator (TPR).

3. Occupational pension schemes are set up by an employer to provide retirement benefits for their employees. These can either be:

   - defined benefit, where the amount paid out depends on years of service with the employer and the salary that's been paid;

   - defined contribution, where the amount paid out depends on the contributions paid into it and investment performance;

   - hybrid, which have elements of both defined benefit and defined contribution pensions.

Trust-based schemes and fiduciary duty

4. Occupational pension schemes are usually trust-based schemes. Each trust-based scheme has trustees, who are separate from the employer, and who hold the assets of the pension scheme for the benefit of the beneficiaries of the scheme. Trustees are responsible for ensuring that the pension scheme is run properly and that the members' benefits are secure.

5. Trustees have a fiduciary duty to pension scheme members – this means a duty of undivided loyalty to act in beneficiaries' best interests.

6. A code of practice has been issued by TPR explaining what trustees need to do in order to comply with the law in this area.

Statement of Investment Principles

7. A Statement of Investment Principles (SIP) is a written statement governing decisions about investments for the purposes of an occupational pension scheme.

8. Trustees of most occupational schemes must prepare, maintain and periodically revise the SIP. A review of the SIP must take place at least every three years and without delay after any significant change in investment policy.

The policy issue and rationale for Government intervention

9. There has long been concern about how fiduciary duties are interpreted in the context of pension investment. For example, some trustees believe that fiduciary duties required pension trustees to maximise returns over a short time frame precluding consideration of long-term factors. The Pensions Regulator has issued non-statutory guidance on this issue but, as found through the second Law Commission report (more details below) and through stakeholder engagement, it has not been effective.

10. This confusion and uncertainty may result in sub-optimal investment decisions being made on behalf of the members of trust based pension schemes. This may mean that the benefits of longer term investment are not maximised or it may, for example, mean trustees are unaware that they could respond to members' ethical beliefs through the way that their pension savings are invested.

11. In 2013 the Law Commission was asked to review the legal concept of fiduciary duty as applied to investment to address uncertainties and misunderstandings on the part of trustees and advisers.

12. The Law Commission reported[1] in 2014 that trustees should take into account factors which are financially material to the performance of the investment, whatever the source. They also concluded that trustees could make investment decisions based on members' views subject to a 2-stage test being met (even if these related to issues that were not financially material)[2].

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[1] Fiduciary Duties of Investment Intermediaries (LC350) - July 2014 - https://www.lawcom.gov.uk/project/fiduciary-duties-of-investment-intermediaries/

[2] The 2-stage test is based on case law which establishes that scheme trustees are allowed to take account of non-financial factors, though there is never an obligation to, if 1) trustees have good reason

13. The Commission proposed that the Government make changes to the regulations to clarify the law in this area. The Government consulted on several of the proposals in 2015[3] but did not find a compelling case for legislation at that time[4]. Instead, The Pensions Regulator (TPR) amended their guidance to address these issues.

14. In 2017 the Law Commission published its findings on, amongst other things, the extent to which the law allows pension funds to select an investment because it would make a positive social impact. This work concluded that, in most cases, barriers to social investment by pension funds were structural and behavioural rather than legal or regulatory[5]. The Commission made further recommendations (broadly similar to those made in its 2014 report) which could be implemented to reduce the impact of these barriers.

15. In December 2017, the Government indicated that it was minded to accept the Law Commission's proposals for changes to regulations and would consult on these in 2018[6].

16. The evidence shows that despite guidance having been issued by TPR, there remains confusion and misapprehension over trustees' responsibilities in this area. Whilst there are clearly some trustees who understand the issues, are actively engaging with them and are reviewing and where necessary amending their investment strategies accordingly, good practice appears to be far from universal.

17. As was noted in the Government's interim response, there is also evidence of trustee misunderstanding, with a commonly held view being that environmental, social and governance (ESG) risks are irrelevant to, or run counter to, financially material concerns. Research by the law firm Sackers[7] found that:

> "[Trustees] also consider ESG (Environmental, Social and Corporate Governance factors) and external governance reviews to be low priorities. Some participants were not sure what ESG meant… Some see ESG as a distraction or potentially detrimental to achieving the scheme's goals."

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to think the scheme members share the concern and 2) the decision does not involve a significant financial detriment.

[3] Consultation on changes to the Investment Regulations following the Law Commission's report 'Fiduciary Duties of Investment Intermediaries' - February 2015 - https://www.gov.uk/government/consultations/changes-to-the-law-on-investments-in-occupational-pension-schemes

[4] Better Workplace Pensions: Reducing regulatory burdens, minor regulation changes, and response to consultation on the investment regulations – November 2015 - https://www.gov.uk/government/consultations/occupational-pensions-reducing-regulatory-burdens-and-minor-regulation-changes

[5] Pension Funds and Social Investment (LC374) – June 2017 - https://www.lawcom.gov.uk/project/pension-funds-and-social-investment/

[6] Pension funds and social investment: interim response – December 2017 - https://www.gov.uk/government/publications/pension-funds-and-social-investment-interim-response.

[7] Effective Governance – the Art of Balance (2017). Sackers/Winmark. - https://www.sackers.com/publication/effective-governance-the-art-of-balance

18. A recent Buzz poll by Professional Pensions[8] found that more than half of respondents do not take ESG factors into account when making or advising on investment decisions, or think of climate change as a financially material risk to their investments or those of their clients. This was a relatively small self-selecting survey but its findings were consistent with those from other sources.

19. Hermes Investment Management conducted a survey[9] with institutional investors which echoed the findings in the Professional Pensions poll. They explain that there is confusion about the nature of ESG and that many investment managers see consideration of these factors as a tick box exercise rather than a prompt to consider the true long term needs of their clients:

> "Investment managers need to think about the society they are building with their saving and understand the laws of small numbers. There is no point striving for a wealthy retirement if society has been destroyed by the ill-considered actions of companies who have been insufficiently held to account by their shareholders."

Policy objectives and intended effects

20. The policy objectives are to improve understanding and practice by trustees so that they:
    - take account of financially material risks, whether these stem from investee firms' traditional financial reporting, or from broader factors covered in non-financial reporting or elsewhere;
    - fulfil the responsibilities associated with holding the investments in members' best interests – whether directly or by others on their behalf - not just through voting, but the full range of stewardship activities, such as monitoring, engagement and sponsoring or co-sponsoring shareholder resolutions;
    - have an agreed approach on the extent, if at all, to which they will take account of the concerns, which in the trustees' opinion members hold not only about financially material risks such as ESG including climate change, but the scheme's investment strategy as a whole; and
    - use the Statement of Investment Principles as a real, effective and regularly-reviewed guide to investment strategy and not as a generic 'box-ticking' document.

21. The intended effects are to improve the pension investment decision making by trustees, to ensure that trustees understand members' views where necessary and to ensure that they regularly review their scheme's investment performance.

22. Requiring trustees of relevant schemes to publish the Statement of Investment Principles and implementation report and a statement setting out how they will take account of members' views is intended to build a greater degree of transparency into the system and will help engaged members understand their investments.

[8] https://www.professionalpensions.com/professional-pensions/news/2468851/climate-change-is-overblown-nonsense-and-not-a-material-risk-says-industry
[9] Responsible Investing: the Persistent Myth of Investor Sacrifice – October 2017 - https://www.hermes-investment.com/ukw/wp-content/uploads/sites/80/2017/10/Hermes_responsible_capitalism_paper.pdf

23. Trustees will also have a better understanding of the meaning of ESG and this should improve their ability to utilise a wider spectrum of investments.

Policy options considered, including alternatives to regulation

Option 1 - Do nothing

24. In July 2014 the Law Commission proposed changes to DWP regulations to clarify the law on fiduciary duties with respect to investment decision making. At the time the Government concluded that the right response was to update guidance on this issue produced by The Pensions Regulator (TPR) rather than moving straight to legislative intervention. Subsequently, TPR issued guidance via the trustee toolkit and also through separate Defined Contribution and Defined Benefit trustee guidance.

25. In 2017 the Law Commission reviewed the barriers to social investment and through a call for evidence concluded that despite the additional guidance from TPR, there is still confusion and misapprehension over trustees' responsibility. The Law Commission recommended legislative changes again in its 2017 report which were broadly similar to those made in 2014.

26. It is therefore clear that an alternative approach to regulation has been attempted. The evidence shows that this has failed to sufficiently address the current shortfall in trustee understanding of how to discharge their fiduciary duty in this respect, as evidenced by:

- the Law Commission's findings as set out in their 2017 report;
- research by Hermes Investment Management[10], the law firm Sackers[11], the publications Professional Pensions[12] and Portfolio Institutional[13];
- stakeholder feedback from round table events run by the DWP.

Option 2 – Review and update guidance

27. In 2016 The Pensions Regulator issued guidance to address the issues arising from the 2014 Law Commission's report. This guidance is clear that trustees have a duty to take environmental, social and governance risks and opportunities into account when these are financially material.

28. The 2017 Law Commission report concluded that despite the TPR guidance, there is still widespread misunderstanding about trustee responsibilities in this area. This finding is supported by the research from Hermes, Sackers, Professional Pensions and Portfolio Institutional as quoted above.

29. TPR guidance for occupational schemes is voluntary and at present the wording of the current regulations on investments has proven to undermine the message

[10] https://www.hermes-investment.com/ukw/wp-content/uploads/sites/80/2017/10/Hermes_responsible_capitalism_paper.pdf
[11] Effective Governance – the Art of Balance (2017). Sackers/Winmark. - https://www.sackers.com/publication/effective-governance-the-art-of-balance
[12] https://www.professionalpensions.com/professional-pensions/news/2468851/climate-change-is-overblown-nonsense-and-not-a-material-risk-says-industry
[13] http://www.portfolio-institutional.co.uk/news-analysis/pensions/esg-important-criterion-well-intentioned-window-dressing-institutional-investors/

in the guidance by equating financially material concerns with ethical concerns. As regulations carry more weight in the courts it is clear why Trustees would err on the side of existing regulations rather than the guidance.

30. For these reasons we are rejecting this as a viable option at this time.

Option 3 – Issue statutory guidance

31. Statutory guidance is the middle ground between guidance and regulation. This guidance can only be issued when we have primary powers to do so and at this time we do not.

32. Therefore this option is not viable at this time.

Option 4 – Regulate to include additional information within a Statement of Investment Principles

33. By October 2019:

    a. require trustees of occupational pension schemes with 100 members or more to update their Statement of Investment Principles (and for trustees of relevant DC occupational schemes – broadly, schemes offering money purchase benefits, subject to a few exceptions – regardless of scheme size, to update their default strategy) to set out how they take account of financially material considerations, including (but not limited to) those arising from Environmental, Social and Governance (ESG) considerations including climate change, in the selection, retention and realisation of investments.

    b. require trustees of occupational pension schemes with 100 or more members to update their Statement of Investment Principles to set out their policies in relation to the stewardship of the investments, including engagement with investee firms and the exercise of the voting rights associated with the investment;

34. In addition, from October 2019, require trustees of occupational pension schemes with 100 or more members to prepare a statement which sets out how they take account of the views which in their opinion members hold in relation to the matters covered in the SIP each time they prepare or revise their SIP ("the statement about scheme members' views").

Option 5 – Option 4 plus regulate to produce an implementation report and publish this document, the SIP and statement about scheme members' views

35. Require trustees of relevant occupational pension schemes (broadly, schemes offering money purchase benefits, subject to a few exceptions) from October 2019 to:

    a. publish the Statement of Investment Principles on a website so that it can be found and read by both scheme members and interested members of the public;

b. publish the statement of scheme members' views on a website on a similar basis;

c. inform scheme members of the availability of the SIP and statement of scheme members' views via the annual benefit statement.

36. Require trustees of relevant occupational pension schemes from October 2020 to:

d. produce an implementation report setting out how they acted on the principles set out in the SIP and explain any change made to the SIP;

e. publish that implementation report and inform members of its availability via the annual benefit statement.

Expected level of business impact

37. For options 4 and 5 there will be costs to schemes and trustees.

Monetised and non-monetised costs and benefits

Volumes of schemes affected:

38. Different schemes are affected by parts of these regulations so the next table shows the volumes affected by each measure.

Table 1: Volumes of schemes impacted by the regulations

Stewardship & members' views Occupational Pension Schemes with 100 or more members	Defined Contribution (DC) [14]	1,050
	Defined Benefit (DB)[15]	3,638
	Total schemes	**4,688**
Financially material considerations Occupational Pension Schemes with 100 or more members and DC	DC and DB with 100+ members[14,15]	4,688
	All DC trust-based schemes with fewer than 100 members[14]	31,660
	…less executive pension plans[16]	*-1,750*
	…less other relevant small schemes[17]	*-26,177*
	Total schemes[18]	**8,421**

[14] http://www.thepensionsregulator.gov.uk/doc-library/dc-trust-presentation-of-scheme-return-data-2018.aspx
[15] http://www.pensionprotectionfund.org.uk/Pages/ThePurpleBook.aspx
[16] Analysis by The Pensions Regulator based on scheme returns data.
[17] Imputation from table 5.4 in http://www.thepensionsregulator.gov.uk/doc-library/dc-trust-presentation-of-scheme-return-data-2018.aspx
[18] Data from The Pensions Regulator shows that there are a very small number of hybrid schemes which offer DC Additional Voluntary Contributions and those that offer only AVCs as DC benefits will be smaller so there has been no reduction applied to the relevant schemes volumes.

trust-based schemes regardless of size		
Implementation report, Statement about members' views and publish these documents and SIP Relevant occupational pension schemes (broadly schemes offering money purchase benefits with a few exceptions[19])	**DC Occupational Pension Schemes with 100+ members**	**1,050**

Option 4

Direct cost to pension schemes

Familiarisation costs

39. There will be costs to all the scheme trustees to familiarise themselves with the new regulations. We assume this all happens in policy year one.

40. The trustees will need to read around one page of regulations for each of the three measures in this option. We assume a speed of one minute to read 300 words so assume a trustee will take around 10 minutes to read and digest the information at an hourly rate of £25.44[20] for each trustee and two trustees per scheme[21].

Table 2: costs of familiarisation

Part of measure	Number of schemes	Cost
Financially material considerations	8,421	**£71,400** (10mins*£25.44 * 8,421*2)

[19] We assume that these are all DC schemes with more than 100 members. This excludes hybrid schemes which offer AVCs as the only part of the DC section, as these are not relevant schemes for the purposes of the regulations. Data from The Pensions Regulator indicates these would be negligible volumes.

[20] Annual Survey of Hours and Earnings 2017 provisional data for professionals with a 27% overheads uplift as stated in the previous Green Book. We will examine this assumption further in the final impact assessment but it is likely to only have a small impact on the EANDCB.

[21] The median number of professional trustees used per scheme (excluding SSAS and micro schemes) in a survey carried out by the TPR was two with a mean of five and with professional trustees serving on a median of seven trustee boards: http://www.thepensionsregulator.gov.uk/docs/professional-trustee-survey-june-2017.pdf. The previous year's report covering all trustees (rather than just professional ones) showed an average of three trustees per scheme; http://www.thepensionsregulator.gov.uk/docs/trustee-landscape-qualitative-research-2016.PDF. An average of three trustees would be a high central estimate since as above, professional trustees are known to serve on more than one board. Therefore we assume a central estimate would be an average of two trustees per scheme.

Stewardship	4,688	**£39,800** (10mins * £25.44 * 4,688*2)
Members' views	4,688	**£39,800** (10mins * £25.44 * 4,688*2)

41. This gives a **one-off cost of £150,900 in 2018/19**.

42. We assume there is no on-going cost since new trustees will have to familiarise themselves with the proposed set of regulations and guidance rather than the previous regulations and guidance in the counterfactual.

Rules for financially material considerations

43. Current case law shows that trustees have a fiduciary duty to take into account financially material factors when making investment decisions, whatever the source.

44. Under existing regulations the SIP should already be stating the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments. Note, however, that this conflates factors which may be financially material (social, environmental considerations) with those which are generally not financially material (ethical).

45. In 2015 The Pensions Regulator issued guidance via its trustee toolkit and subsequently updated its DC and DB trustee investment guidance documents to ensure trustees are aware of these responsibilities.

46. The measure proposed does not require trustees to create a new policy in relation to financially material considerations, including Environmental, Social, Governance or climate change. Instead, it requires trustees to state their existing policies about financially material considerations (including environmental, social and governance including climate change) in the SIP from October 2019. In practice, schemes may choose to enhance their existing policies in these areas or to take into account factors that they did not previously consider. This is their own choice and not a requirement of the legislation.

Rules for stewardship

47. The Financial Reporting Council (FRC) has a Stewardship Code[22] which trustees can follow. Despite the number of pension scheme signatories to the code being relatively low, The Pensions Regulator believes that most schemes would have a policy on stewardship.

48. The measure proposed does not require trustees to create a policy in relation to stewardship. It requires trustees to state their existing policies in the SIP by October 2019. In practice, schemes may choose to enhance their existing policies in these areas or to take into account factors that they did not previously consider.

Rules for members' views

[22] https://www.frc.org.uk/investors/uk-stewardship-code

49. In addition to financially material factors, trustees can (but are not required to) take account of members' views on factors that they consider to be non-financially material. The Law Commission set out in its report a 2-stage test based on case law, which must be met before trustees can take account of these factors. These are that the trustees should have a good reason to think the members hold the concern and secondly, the decision should not involve significant financial detriment.

50. The proposed measure requires trustees of schemes, before they prepare or revise the SIP, to state their policies on taking into account the views which in their opinion members hold, from October 2019. It does not require the scheme trustees to take account of their actual members' views and in many cases this could be almost impossible given the low levels of member engagement (having information from a very small proportion of members' views would make it more difficult to meet the 2-stage test as set out in the Law Commission's report in 2017). However, the trustees would have clarification that they can take members' views into account should they wish. This could for example, be in the situation where the trustees can use knowledge about the views of similar demographics of the population to their members and infer the knowledge applies to their members[23].

51. The measure does not require scheme trustees to create a policy on taking into account members' views and it can be appropriate for a scheme to state that they do not take this into consideration. However, it may be that schemes will choose to enhance their existing policy in this area.

Costs to review and where necessary update the SIP for financially material considerations and stewardship

52. Existing regulations require SIPs to be reviewed and where necessary updated at least every three years. We expect that all schemes will have a policy on these factors to comply with case law, legislation and TPR guidance. It may be that schemes have a policy of "no policy" but this would need to be justified, and these regulations will not require them to newly develop policies where the existing justification still holds.

53. We assume a scheme will not face additional burden if their next triennial SIP is due to be reviewed and, where appropriate, updated between October 2018 and October 2019. Trustees of schemes in this situation will already have to incur expense to review and potentially update their SIP and existing case law requires them to consider financially material factors.

54. The measure on stating financially material considerations is designed to clarify the requirements of the existing regulations so should be considered as part of the SIP update once trustees are familiar with them. In effect, schemes might have to separate wording on financially and non-financially material considerations that are required under existing regulations but this is a simple change that we consider will not impact the overall cost of updating a SIP.

55. There may be some schemes, in relatively limited circumstances, which do not have or need a policy on stewardship and therefore will need to add a line with

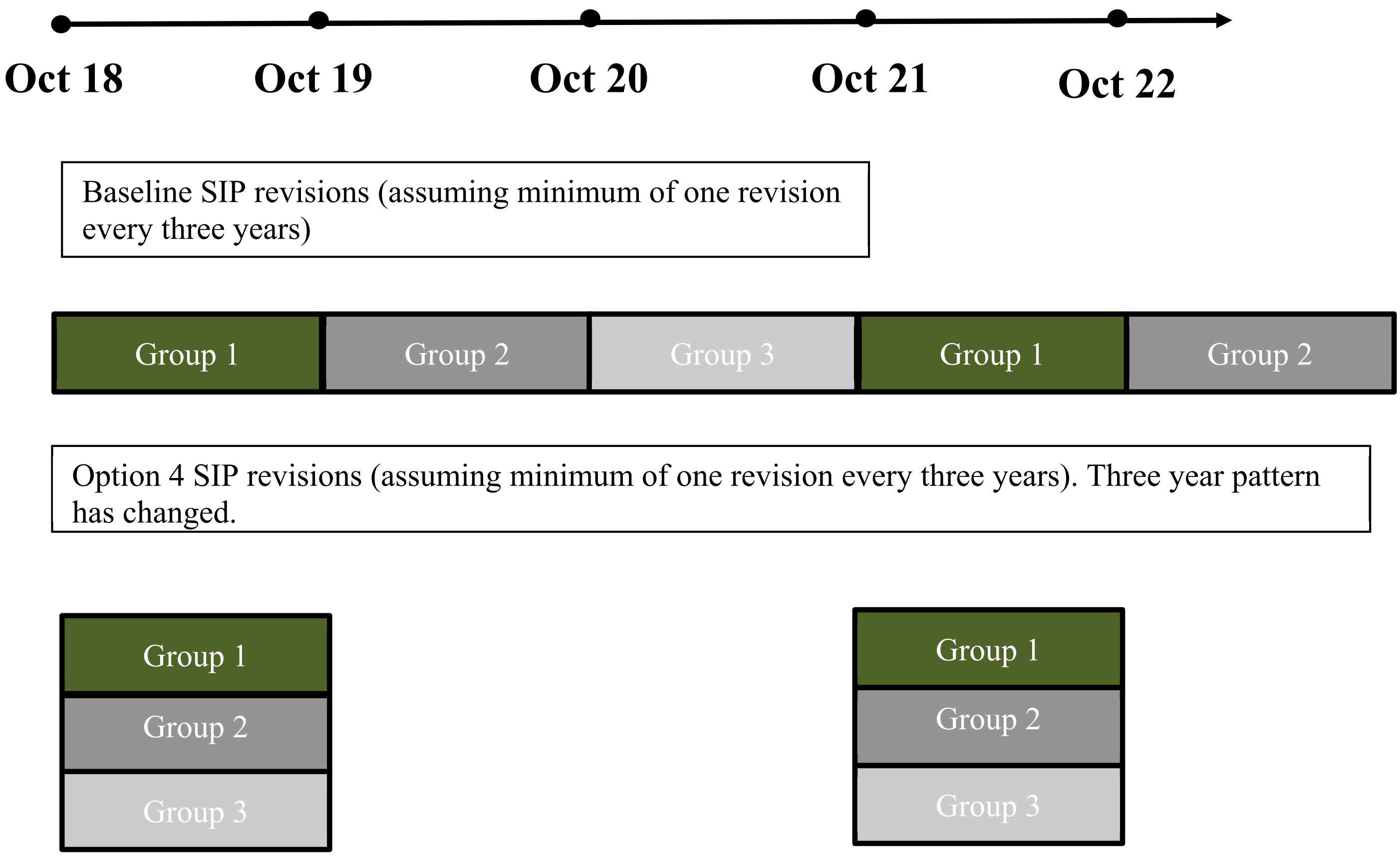
[23] The Law Commission use the decision not to invest in the manufacture of cluster bombs as an example of this. The fact that the Convention on Cluster Munitions, which prohibits cluster bombs, has been ratified by the UK could give trustees reason to believe most people would consider them wrong.

their policy which could be a simple statement to this effect, so we consider this proposed requirement may not impact on the overall cost of updating the SIP.

56. A total of 8,421 schemes would need to update their SIP to state (if not already covered) the financially material factors that they considered and of these, 4,688 would also need to state their policy on stewardship[24].

57. A maximum[25] of two thirds of the schemes will face costs to update their SIP outside of the normal course of triennial updates (those with usual triennial updates expected between October 2019 and October 2021) to ensure they have updated the SIP by October 2019. This is shown in Figure 1 below.

Figure 1: Baseline and Option 4 minimum three year SIP revision profiles



58. We have received estimates from stakeholders[26] that the cost of these updates could be in the range of £3,000 to £5,000.

59. Therefore the cost to update the SIP outside of a usual triennial update would be 8,421 x 2/3 x £4,000 = **£22.5 million** in the first year of the policy (October 2018 to October 2019).

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[24] We do not have information on how many schemes may already be stating the information in the proposed regulations within their SIP.
[25] Maximum since some schemes may update their SIP more often than every three years so there may be additional ones updating in the normal course of events before October 2019.
[26] Stakeholders covered a variety of expertise from large master trusts to trustee consultancy firms.

60. However, this could mean that schemes have a change in triennial cycle pattern which is also shown in Figure 1.

61. This would result in none of these schemes requiring revision to a SIP in policy years two and three and every three years after that which **gives a benefit in each of those years of £11.2m with additional costs of £22.5 million in policy years four and every three years from there**.

62. This changes the cost profile of the schemes and the total impact can be seen in table 3 (in the Summary section).

63. We assume that there are no on-going direct costs to business. The financially material considerations will be considered as part of the usual revision and possible updating of the SIP and once an effective policy of stewardship which meets trustees' duties has been stated, the scale of change is likely to be relatively small.

Costs to set out how the members' views are taken into account when revising the SIP

64. At present a SIP may or may not contain the scheme's policy on taking into account members' views.

65. Trustees for DC default funds already have to ensure they have assessed the value for money for members under current regulations. However they would not have to necessarily consider the views of members when making investment decisions. This will continue to be the case.

66. The scheme trustees will have to produce a statement about members' views when they revise their SIP on or after October 2019. In practice, scheme trustees could draft a statement about members' views at the same time as they update the SIP to show how they have decided to act on financially material and stewardship considerations. We assume that the costs of producing this statement would be absorbed within the cost of updating the existing policies on stewardship and consideration of financially material risks, which would be £4,000 each.

Indirect cost to pension schemes

67. In practice, it is likely that pension schemes will choose to enhance their existing policies as a result of this clarification of responsibilities through regulations. At present some schemes might have no explicit policy on ESG or stewardship and might subsequently develop policies.

68. Information received from stakeholders to date indicates that they expect the main costs from this measure to be in the area of developing policies with costs expected to be in the region of £20k to £50k per scheme that chooses to do this.

69. Since schemes will have to state their policy on how they take into account members' views it may be that they will conduct engagement activities to better understand these views. These activities could be costly, depending on the approach chosen, For example stakeholders have told us that running postal surveys could cost in the region of £millions or that market testing of amendments to SIPs could be in the region of £10k. However, it is for individual schemes to determine what will satisfy the trustees and not a requirement of the regulations.

70. We do not know how many schemes will develop their policies in these areas so have not provided an overall monetised indirect cost to pension schemes.

Direct benefits to pension schemes

71. The Law Commission found that there was confusion around the reporting of financially material risks and opportunities and often conflation with non-financial considerations under current regulations.

72. There is confusion with some trustees about whether issues such as climate change are purely ethical considerations. Also the current regulations appear to limit the broader financial considerations that can be taken into account.

73. The regulation changes will clarify the duty on trustees to take account of financially material issues, including Environmental, Social and Governance (including climate change), to make it easier for trustees to make better decisions about the broad spectrum of financially material factors.

74. It would be disproportionate to estimate the size of these direct benefits so they have not been included in the EANDCB calculation.

Indirect benefits to members

75. The clarification of trustees' duty should result in all financially material considerations being factored into investment decisions. This should lead to better investment decisions and returns for the scheme members, ultimately delivering higher retirement income.

76. There could be an indirect benefit to members because their views on investments could be better taken into account. Research by the Defined Contribution Investment Forum found that 40% of those surveyed would contribute more to their pension saving if they knew it was being used for responsible investments[27]. 56% would have more trust in their DC pensions and 57% would engage more.

77. It would be incorrect to assert that this policy would definitely result in these outcomes due to the low level of member engagement and knowledge about pensions. However where members are engaged, they could benefit from increased trust, engagement and contributions.

78. The change in investment profile as a result of taking into account members' views could result in slight variations in returns but should not be significantly detrimental to members so as to pass the Law Commission's 2-stage test.

79. It would be disproportionate to estimate these potential indirect benefits so they have not been included in the EANDCB calculation.

Costs to The Pensions Regulator

[27] Survey base is all UK adults aged 22-65 with a DC pension. https://www.dcif.co.uk/wp-content/uploads/2018/04/navigating-esg-final-lo-res.pdf.

80. The Pensions Regulator will need to update their guidance to trustees. They have indicated that this cost will be minimal since there is a planned review of guidance which would cover this issue.

Option 5

Direct costs to pension schemes

Familiarisation

81. There are trustees of 1,050 relevant schemes that will need to be familiar with the new regulations. We assume this all happens in 2018/19 after the regulations are laid and this will take around 10 minutes of a trustees' time at an hourly rate of £25.44[20] (1 page of writing at an average of 600 words per page and a reading speed of 300 words per minute) and two trustees per scheme[21]. This gives a **one-off cost of £8,900 in 2018/19**.

Publish the SIP and the statement about members' views

82. All relevant schemes will need to publish their current SIP and the statement about members' views.

83. These schemes already have to make information on costs and charges available online so they will already have a suitable web hosting arrangement and process for uploading information[28]. We assume that this will take 20 minutes[29] at an administrator's wage of £19.48 an hour[30].

84. The SIP has to be published from October 2019 so we assume they all publish in the first year of the policy when they have revised the SIP in order to be compliant on 1 October 2019. They will then need to re-publish whenever they revise the SIP. Schemes already have to review the SIP at least every three years and revise it where appropriate. We assume that all schemes will have to re-publish every three years though in reality some will not have to and some might have to publish more often. The estimated costs incurred are small and so we consider sensitivity analysis to be disproportionate.

85. This gives an overall **cost to publish SIPs of £6,800 in the first year of the policy and the same every three years from then**.

86. The statement of members' views are likely to be published at the same time as the SIP and so the estimated costs are the same as those above of **£6,800 in the first year of the policy and the same every three years from then**.

Updating the annual benefit statement for the SIP link

[28] SI 2018 No. 233: The Occupational Pension Schemes (Administration and Disclosure) (Amendment) Regulations 2018 http://www.legislation.gov.uk/uksi/2018/233/contents/made
[29] This is consistent with the assumption in the disclosure of costs and charges impact assessment, http://www.legislation.gov.uk/uksi/2018/233/pdfs/uksiod_20180233_en.pdf. This is also consistent with stakeholder feedback gathered about the process which stated from no cost to 2 hours of work.
[30] Annual Survey of Hours and Earnings 2017 provisional data for administrators with a 27% overheads uplift as stated in the Green Book.

87. Each of the 1,050 relevant schemes will need to update members' annual benefit statement with a line informing members of the location of the latest SIP and the members' views statement. Consistent with the assumptions used in the simplification of advice requirements regulations[31] and disclosure of costs and charges[29] we assume this takes 10 minutes of a pension administrator's time at £19.48 an hour.

88. The total cost to update the annual benefit statement is **£3,400 in the first year of the policy**. There is no on-going cost.

Creating and publishing an implementation report

89. The trustees of each of the 1,050 relevant schemes will need to create an implementation report which they will then publish from October 2020.

90. Views from a small group of stakeholders have been quite varied about the amount of time this will take and the cost. From "very little" to 10 to 20 hours internal time plus between £5k and £10k in fees (total c. £5,250 to £10,500 at £25.44 an hour[20]).

91. Since we have information from a small sample this makes it quite speculative at this stage. In 2015 there was a change to the charges and governance regulations which required schemes to review their default strategies and the underlying performances of the funds. Engagement with industry stakeholders resulted in an estimate of £1,000 being used to comply with regulations but acknowledging that there could be higher costs for schemes maybe going over and above the requirements. Since this is likely to be a similar task we will use an assumption that it will cost £1,000 to produce an implementation report based on evaluating performance[32] but have considered some sensitivities below.

92. **This leads to costs of £1,050,000 in policy year two and each subsequent year to create the implementation report**.

93. Using the same assumptions for publication as in Option 4 the costs to publish the implementation report are **£6,800 in policy year two and each subsequent year**.

Updating the annual benefit statement with a link to the implementation report

94. Using the same assumptions for updating the annual benefit statements for the SIP the costs to update the annual benefit statements **is £3,400 in policy year two** (one year later than for the SIP).

Costs to The Pensions Regulator

95. The Pensions Regulator will need to update their guidance to trustees. They have indicated that this cost will be minimal since there is a planned review of guidance which would cover this issue.

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[31] http://www.legislation.gov.uk/ukia/2017/115/pdfs/ukia_20170115_en.pdf

[32] Consistent with the charges and governance regulation changes in 2015 which considered a review of performance of the DC default schemes every three years. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/364324/better-workplace-pensions-impact-assessment.pdf.

Summary

96. Table 3 sets out all the direct costs to business.

The estimated annual net direct cost to business (EANDCB) for option 4 is £2.3m and for option 5 is an additional £0.9m. The total EANDCB for option 5 is £3.2m.

Table3: Summary of Direct costs to Business (in £millions)

Policy year	1	2	3	4	5	6	7	8	9	10
	Oct 18 – Sep 19	Oct 19 – Sep 20	Oct 20 – Sep 21	Oct 21 – Sep 22	Oct 22 – Sep 23	Oct 23 – Sep 24	Oct 24 – Sep 25	Oct 25 – Sep 26	Oct 26 – Sep 27	Oct 27 – Sep 28
Familiarisation (option 4 only)	0.15	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Updating the SIP for financially material considerations and stewardship (includes changes to triennial cycle)	22.46	-11.23	-11.23	22.46	-11.23	-11.23	22.46	-11.23	-11.23	22.46
Producing statement about members' views	In above updated SIP figures									
Total Option 4	22.61	-11.23	-11.23	22.46	-11.23	-11.23	22.46	-11.23	-11.23	22.46
Familiarisation (additional option 5 only)	0.01	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Publishing the SIP	0.01	0.00	0.00	0.01	0.00	0.00	0.01	0.00	0.00	0.01
Inserting a line in the Annual Benefit Statement to point to the SIP	0.003	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Creating implementation report	0.00	1.05	1.05	1.05	1.05	1.05	1.05	1.05	1.05	1.05
Publishing the implementation report	0.00	0.01	0.01	0.01	0.01	0.01	0.01	0.01	0.01	0.01
Inserting a line in the Annual Benefit Statement to point to the implementation report	0.000	0.003	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Publish the statement of members' views	0.01	0.00	0.00	0.01	0.00	0.00	0.01	0.00	0.00	0.01
Total additional for Option 5	**0.03**	**1.06**	**1.06**	**1.07**	**1.06**	**1.06**	**1.07**	**1.06**	**1.06**	**1.07**
Total cost for Option 5	**22.63**	**-10.17**	**-10.17**	**23.53**	**-10.17**	**-10.17**	**23.53**	**-10.17**	**-10.17**	**23.53**

Sensitivities

Compliance assumed in the baseline

97. It may be that some scheme trustees are not fully compliant with their fiduciary obligations at present if they are not taking into account long term financially material factors. So there could be schemes which will sustain additional costs to comply with the counterfactual to the policy. These costs are excluded from this impact assessment.

Volume of schemes affected

98. There has been a consistent reduction in the volumes of trust-based schemes since 2009. There were 1,660 DC trust-based schemes with 100 or more members in 2009 and this reduced to 1,050 in 2017[33]. This is due to consolidation of schemes. Indications are that this will continue, particularly in the short term as there is evidence that there will be further consolidation of single employer schemes into master trusts. The number of master trusts is also expected to decline this year as a result of the introduction of a new authorisation and supervisory regime in this sector of the market. This means that the volumes of schemes that will be affected by the policy is likely to be lower than this assessment shows. However we do not have information about how much lower it will be and so have not attempted to forecast the reduction in volume.

Variance around costs of producing an implementation report

99. We approached a small number of stakeholders for evidence to feed into this assessment. These may not be representative of the full population of schemes. In particular the costs of updating a SIP are likely to vary depending on issues such as whether external advisers or internal trustees produce the SIP and the level of detail that is within them.

100. We used an assumption of £1,000 for a scheme to produce an implementation report. This was based on the assumption used for schemes to review their default strategy from previous impact assessment analysis. The amounts we were given from a small group of stakeholders for the production of an implementation report varied from “very little” to £5k to £10k” (where reference to actual amounts was given), each of these from relatively large schemes.

101. If we assumed that the cost was £2,500 (midway of the two responses assuming that some of the larger cost includes some activity over and above that necessary to comply with regulation) instead of £1,000 then the EANDCB for option 5 would be an additional £2.3m on top of option 4 costs instead of the best estimate of an additional £0.9m. The total EANDCB for option 5 would be £4.6m.

Small and Micro Business Assessment

102. Small and micro businesses, where they run their own pension schemes, are only impacted by the inclusion of a statement in DC schemes’ default strategy about the financially material factors including ESG and climate change which the scheme takes into consideration when making investment decisions. They are excluded from the rest of the policy. The vast majority of small and micro

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[33] http://www.thepensionsregulator.gov.uk/doc-library/dc-trust-presentation-of-scheme-return-data-2018.aspx

businesses required to enrol staff into a pension scheme because of automatic enrolment use master trust pension schemes, rather than running their own occupational scheme[34]. The smaller the scheme, the more likely the employer is to use a DC scheme and the more likely this is to be a master trust. Government has also legislated[35] to make it easier for trustees and sponsoring employers of DC schemes to close.

103. The smallest DB schemes are out of scope of these regulations altogether.

104. Anecdotally, we hear that trustees of smaller schemes are amongst those who are confused about the issues raised by the Law Commission. It is essential they have clarity on their long term investment decision making to ensure their members, who are their current or former employees, are in properly governed schemes.

Monitoring and Evaluation

105. We recognise the importance of monitoring and evaluation, but for such a small measure it would be disproportionate to commit to a formal programme of evaluation. We will, however, continue to work closely with our stakeholders across the pensions industry to keep this policy under review and should any issue arise with the policy, we will assess the evidence and, if appropriate, consider whether any changes may be necessary.

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[34] Up to March 2017, 92% of the schemes used for AE by employers with 1-4 staff members were DC trust based schemes compared to 53% for schemes used for AE by employers with more than 30 staff members. 99.8% of the DC trust based schemes used for AE by employers with fewer than 30 staff members were master trusts compared to 97.8% for those with more than 30 staff members. http://www.thepensionsregulator.gov.uk/docs/automatic-enrolment-commentary-analysis-2017.pdf

[35] The Occupational Pension Schemes (Preservation of Benefit and Charges and Governance) (Amendment) Regulations 2018